

DECISION



THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548

FILE: B-221897

DATE: May 29, 1986

MATTER OF: Marine Design Technologies, Inc.

DIGEST:

1. Where a cost-reimbursement contract is involved, contracting agency's cost realism analysis of the offerors' proposed costs is a fundamental part of the proposal evaluation process, since the government bears the risk of loss due to cost overruns. Upward adjustment of the protester's proposed costs based on the cost realism analysis does not constitute a determination that the protester is nonresponsible, since the issue of responsibility arises only after the evaluation of proposals is completed and the prospective contractor is selected.
2. Contracting officer's reliance in cost realism analysis on the protester's actual overhead rate from prior years rather than the rate proposed by the protester was reasonable where historical data showed a significant discrepancy between the protester's proposed and actual costs under its prior contracts and the contracting officer found that the actual data available did not support the protester's estimates of work to be performed under existing and potential contracts on which its proposed overhead rate was based.

Marine Design Technologies, Inc. (MDT) protests the award of a cost-plus-fixed-fee contract to STV/Sanders & Thomas, Inc. (STV) under request for proposals (RFP) No. N00140-85-R-0091, issued by the Navy for engineering, technical, and analytical services in support of three programs, the integrated launch and recovery television surveillance program, the horizon reference set program, and the flight deck status and signaling system program. The protester challenges the Navy's cost realism adjustment

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of both its and the awardee's proposed costs. We deny the protest.

The RFP was issued on March 22, 1985, with initial proposals due on April 25. Section M31(b)(ii)(a) of the RFP provided that proposals would be evaluated as follows:

"The Technical Proposal must be clearly presented with sufficient information to allow evaluation on the requirements stated herein. The two most important criteria are (1) and (2) below; therefore, they will be judged equally. Criteria (3), (4), and (5) are in order of descending importance:

- (1) Corporate Past Experience
- (2) Personnel Resources (Quantity and Quality of Available Personnel)
- (3) Management Plan/Approach (Offerors' organization, management, and start up plans)
- (4) Contractor Facilities
- (5) Cost and Cost Realism."

With regard to the fifth evaluation factor, cost and cost realism, section M31 specifically advised offerors that their proposed costs would be evaluated for cost realism:

"Although cost is the least important evaluation factor, it is an important factor and should not be ignored. The degree of its importance will increase with the degree of equality of the proposals in relation to the other factors on which selection is to be based. Furthermore, costs will be evaluated on the basis of cost realism. Cost realism pertains to the offeror's ability to project costs which are realistic and reasonable and which indicates that the offeror understands the nature and scope of the work to be performed." (Emphasis added.)

Initial proposals were received from the protester and the awardee. The Navy's evaluation of the technical proposals ranked STV higher overall than MDT; specifically, STV was ranked superior to MDT on the two most important technical factors (corporate experience and personnel resources), while MDT was ranked superior to STV on the remaining two factors (management plan/approach and contractor facilities). The technical evaluation concluded, however, that both proposals were fully acceptable and both offerors were considered capable of fulfilling the requirements of the RFP.

The contracting officer also performed a cost realism analysis of the offerors' initial cost proposals and revised both proposals upward as follows:

	<u>Proposed</u>	<u>Cost realism</u>
STV	\$1,194,762.88	\$2,005,156.69
MDT	\$ 955,278.29	\$1,526,350.61.

The increase in STV's costs was due to the contracting officer's decision to apply higher direct labor rates and a higher labor escalation factor than proposed by STV.

The cost realism analysis of the MDT proposal focused on the proposed overhead rate. In response to the Navy's request, the Defense Contract Audit Agency (DCAA) evaluated MDT's cost proposal and recommended an overhead rate of 46 percent of direct labor costs, an increase over MDT's proposed rate of 33.8 percent. DCAA's calculation of the overhead rate was based on two assumptions: (1) that under MDT's existing indefinite quantity contracts, the government would place delivery orders with MDT in the amounts estimated in its proposal; and (2) that MDT would be awarded another new contract covering the period of performance under the RFP.^{1/} DCAA recognized that the overhead rate would be higher if these two assumptions proved inaccurate, and, as a result, recommended that a ceiling on the overhead rate be included in the contract if awarded to MDT to protect the government from potential increases in the actual overhead rate.

^{1/} Although the DCAA report does not further identify the new contract, MDT's best and final offer lists eight current RFPs under which MDT had submitted offers. For purposes of calculating the overhead rate, MDT's proposal assumed that MDT had a 31 percent chance of receiving an award under each RFP.

After considering the DCAA report, the contracting officer concluded that the number of actual delivery orders placed to date under MDT's existing contracts (one order under each of two contracts) did not support MDT's estimate of the delivery orders which would be placed under those contracts. Based on this finding, the contracting officer decided to apply an overhead rate of 110 percent, the rate actually used by MDT in current invoicing, rather than the 46 percent rate recommended by DCAA.

Discussions then were conducted with STV and MDT on January 2, 1986, and both offerors were requested to submit best and final offers. By letter dated January 7, the Navy advised MDT to "carefully review the proposed overhead rate of 33.8 percent as it appears to be grossly understated when compared to recent historical actuals running at approximately 110 percent." The Navy also stated that MDT would have to provide "thorough and complete documentation" to support use of an overhead rate of less than 110 percent.

STV's best and final offer revised its technical proposal by substituting certain personnel and using actual wage rates; as a result, although STV's cost proposal increased, the agency's cost realism estimate decreased.^{2/} MDT did not revise its technical proposal, but did increase its proposed overhead rate to 46.4 percent. The Navy's technical ranking of the two proposals remained unchanged, with STV considered superior overall to MDT. The offeror's cost proposals and the cost realism adjustments are as follows:

	<u>Initial Proposal</u>	<u>Initial Cost Realism Adjustment</u>	<u>Best and Final Offer</u>	<u>Final Cost Realism Adjustment</u>
STV	\$1,194,726.88	\$2,005,156.69	\$1,413,066.66	\$1,486,673.16
MDT	\$ 955,278.29	\$1,526,350.61	\$1,041,847.09	\$1,536,374.94.

^{2/} In evaluating STV's initial cost proposal the agency used current actual wage rates for the individuals proposed. These were higher than the average pool rates included in the STV cost proposal. In its best and final offer, STV proposed different personnel with lower actual wage rates. Because STV used actual rates, its best and final cost proposal increased slightly relative to its initial cost proposal. Due to the lower actual wage rates in STV's best and final cost proposal, the agency's realism adjustment decreased.

The cost realism adjustment of MDT's best and final offer was based on application of the 110 percent overhead rate. The contracting officer concluded that the 46.4 percent overhead rate proposed by MDT in its best and final offer was unrealistic, based on the historical data regarding MDT's overhead rate. Specifically, under MDT's cost-reimbursement contracts with the Navy from 1983 through 1985, MDT's actual overhead rates, ranging from 121 percent to 151.5 percent, were significantly higher than the overhead rates proposed by MDT, which ranged from 35.2 percent to 52.5 percent. The contracting officer also found that MDT had overestimated its chances of receiving awards under the other current RFPs under which MDT had submitted proposals, based on informal advice from the contracting activities involved regarding MDT's ranking in those procurements.

Based on the technical evaluation and cost realism analysis, award was made to STV on February 20 as the offeror with the superior technical proposal and lower proposed costs as adjusted for cost realism.

The protester argues that the Navy's upward adjustment of its proposed costs is based on a finding that the protester could not perform under the RFP at its proposed cost and therefore constitutes a determination by the Navy that the protester is not a responsible offeror. The protester maintains that, since MDT is a small business, the Navy was required to refer this nonresponsibility determination to the Small Business Administration (SBA) for review under the certificate of competency (COC) procedures as provided by 15 U.S.C. § 637(b)(7)(A) (1982). MDT also contends that in evaluating its proposal for cost realism, it was improper for the Navy to ignore the effect of MDT's anticipated contract work on MDT's overhead rate and instead apply a significantly higher overhead rate based on historical data alone. The Navy disagrees with the protester's contentions, arguing, first, that the cost realism adjustment related to evaluation of MDT's proposal, not its responsibility; and, second, that the contracting officer's decision to apply an overhead rate based on historical data was reasonable. Finally, based on materials first provided in the Navy's report on the protest, MDT argues that the Navy's cost realism analysis of the awardee's proposal was defective in several respects.

MDT first contends that the Navy's decision to increase MDT's proposed costs in effect constitutes a

finding that MDT is not a responsible offeror, which should have been referred to the SBA for a final determination under the COC procedures. We disagree. MDT's argument ignores an important distinction between fixed-price contracts, under which an agency's findings regarding an offeror's ability to perform at its proposed price relate to its responsibility, and cost-reimbursement contracts of the kind involved in this case. Under a fixed-price contract, the offeror generally bears the risk of loss if its costs are higher than anticipated; under a cost-reimbursement contract, the risk of loss shifts to the government. As a result, when a cost-reimbursement contract is involved, the contracting agency must guard against a buy-in by analyzing each offeror's proposed costs in terms of their cost realism, since, regardless of the costs proposed by the offeror, the government is bound to pay the contractor its actual and allowable costs. Advanced Technology Systems, Inc., 64 Comp. Gen. 344, 345-346 (1985), 85-1 CPD ¶ 315.

The Navy's cost realism analysis of MDT's proposed costs thus was a fundamental part of the proposal evaluation process relating to the accuracy of the cost proposals. This was consistent with section M31 of the RFP which, as noted above, specifically advised offerors that a cost realism analysis would be part of the Navy's evaluation of proposals. The analysis was to be used as a basis for comparing the actual cost to the government of one proposal to another. In contrast, the issue of responsibility, i.e., whether an offeror has the minimum capacity to perform the proposed contract, arises only after the prospective contractor has been selected. Where, as here, the protester is not in line for award as a result of the evaluation of proposals, the issue of its responsibility is not even reached and the COC procedures are inapplicable. See The Communications Network, B-215902, Dec. 3, 1984, 84-2 CPD ¶ 609.

The protester next contends that it was improper for the contracting officer to reject MDT's estimates of the work it would be performing under its other existing and potential government contracts, and instead rely solely on actual overhead data from prior years. MDT argues that its current business condition is so substantially changed that reliance on the prior years' data is unreasonable. We find that it was reasonable for the contracting officer to use the actual overhead rates from recent years in analyzing MDT's proposed costs.

When a cost-reimbursement contract is to be awarded, the offerors' estimated costs of contract performance and their proposed fees should not be considered as controlling since the estimates may not provide valid indications of final actual costs. See Federal Acquisition Regulation, 48 C.F.R. § 15.605(d) (1984). The government's evaluation of estimated costs thus should determine the extent to which the offerors' estimates represent what the contract should cost, assuming reasonable economy and efficiency. This determination in essence involves an informed judgment of what costs actually would be incurred by acceptance of a particular proposal. Ecology and Environment, Inc., B-209516, Aug. 23, 1983, 83-2 CPD ¶ 229. Because the contracting agency clearly is in the best position to make this cost realism determination, we will disturb its determination only where it is shown to be unreasonable. Polaris, Inc., B-220066, Dec. 16, 1985, 85-2 CPD ¶ 669.

Here, the contracting officer initially questioned MDT's projections based on the considerable discrepancy between MDT's proposed and actual overhead rates under several Navy contracts since 1983.^{3/} These historical data reasonably raised questions in the contracting officer's mind regarding the accuracy of MDT's proposed overhead rate under the current RFP and justified close scrutiny of MDT's projections. During discussions, the Navy gave MDT an opportunity to support its proposed overhead rate and demonstrate that its prior, much higher actual overhead rate would not continue under the proposed contract. MDT responded by slightly raising its proposed overhead rate (33.8 percent to 46.4 percent) and by justifying the new rate with its estimates of anticipated work orders under three existing contracts and projected contract awards under other current RFPs. In our view, MDT has not shown that it was unreasonable for the contracting officer to reject these projections in favor of the historical overhead data.

MDT argues that reliance on the prior years' data is improper because it performed significantly less work in 1983 and 1984 than currently; MDT does not explain, however, why its overhead rate for 1985, which also was significantly higher than MDT's current projection, was not an accurate indication of the actual overhead rate that could be expected under the RFP. Further, the contracting

^{3/} As noted above, the proposed overhead rates ranged from 35.2 percent to 52.5 percent, the actual rates from 121 percent to 151.5 percent.

officer found that MDT's estimate of new contract awards was overstated and that MDT's projections of work orders under its existing contracts were unrealistic, based on the number of actual orders placed under those contracts to date. In support of its own estimates, MDT relies on the actual number of orders placed under the existing contracts since January 1986. The Navy's cost realism analysis was conducted in January 1986, however, and, in our view, it was reasonable for the contracting officer to rely on the information available to date (through December 1985) in assessing the probability of MDT's receiving work orders at the rate MDT projected.

In light of this information and the prior years' data showing a significant discrepancy between MDT's projected and actual overhead rates, we find that it was reasonable for the contracting officer to conclude that MDT's projected increase in business under its current and anticipated government contracts was not certain or significant enough to justify relying on MDT's projected overhead rate.

As MDT points out, the contracting officer rejected DCAA's recommendation to use a 46 percent overhead rate with a ceiling on the actual rate to be charged. In our view, the decision not to follow the DCAA recommendation was reasonable in light of the contracting officer's conclusion that the two key assumptions on which the DCAA recommendation was based (projected work orders and new contract awards) were not accurate. In any event, DCAA audit reports are advisory only; there is no requirement that they be adopted by a contracting officer. Booz, Allen & Hamilton, B-213665, Sept. 24, 1984, 84-2 CPD ¶ 329.

Finally, MDT challenges the Navy's cost realism analysis of STV's proposal on several grounds.^{4/} The record shows that in its final cost realism analysis of STV's proposal, the Navy reduced STV's proposed costs based on STV's substitution in its best and final offer of certain personnel at lower wage rates. MDT's principal argument is that the reduction in STV's adjusted proposed costs was greater than justified by the size of the

^{4/} Because these arguments are based on information first made available to MDT as part of the agency report on the protest, they could not be raised in the initial protest submission and, as a result, the Navy has not responded to them.

personnel reduction in STV's best and final offer; specifically, MDT argues that the approximately \$500,000 reduction made by the Navy in STV's adjusted costs would require an unrealistic reduction in wage rates. The record does not support MDT's contention. STV's initial offer used average pool labor rates. In its best and final offer, STV changed some of the personnel proposed and used actual wage rates paid those individuals. Consequently, the labor costs in STV's best and final offer went up. The agency's realism adjustment fell, however, because the actual wage rates of the substituted personnel were lower than the actual wage rates for those listed in the initial proposal. The agency's adjusted reduction in direct labor costs is consistent with its assessment of the average reduction in actual hourly wage rates proposed in STV's best and final offer. Further, the agency correspondingly reduced its adjustment of STV's overhead rate, in an approximately equal amount.

MDT also challenges the Navy's decision to accept the overhead rate proposed by STV even though MDT's proposed rate was challenged, and to accept weighted averages for the direct labor rates from STV, rather than the straight line averages submitted by MDT. With regard to the overhead rate, the record shows that, in contrast to its report on MDT, DCAA took no exception to STV's proposed overhead rate. In any event, the extent to which proposed costs are examined is a matter within the contracting agency's discretion and the agency is not required to verify every cost item in an offeror's proposal. DDL Omni Engineering, B-220075, B-220075.2, Dec. 18, 1985, 85-2 CPD ¶ 684. With regard to the direct labor rates, the final cost realism analysis was based on the average actual rate in those categories where more than one hourly rate was proposed; there is no indication that the average was weighted, as MDT contends.

MDT requested that it be awarded its proposal preparation costs and the costs of pursuing the protest. Recovery of costs is allowed only where a protest is found to have merit. 31 U.S.C.A. § 3554(c)(1) (West Supp. 1985); Bid Protest Regulations, 4 C.F.R. § 21.6(d) (1985). Since we have denied the protest, we also deny MDT's claim for recovery of costs.

Harry R. Van Cleve

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